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1. Investment Highlights

Table 1: Company Comparisons

Company (Ticker)	QRQ Rating	Price @ 3/3/98	EPS* 1997	EPS* 1998E	EPS* 1999E	P/E Ratio 1997E	P/E Ratio 1998E	P/E Ratio 1999E	Quarterly EPS* 4Q96	Quarterly EPS* 4Q97		% chg	5-Yr EPS Growth	Div Yield	'98E Div Payout	1998E % Internally Financed [1]	1998E EBITDA Mult.
AT&T (T)	A-3-3-7	$61.81	$2.71	$3.50	$4.10	22.2	17.7	16.1	$0.75	$0.81	A	2.6%	8%	2.2%	34%	67%	7.4
MCI Comm (MCIC)	6-6	$48.13	$1.21	$1.35	$1.35	43.4	41.8	35.6	$0.44	$0.10	A	-77.1%	12%	0.1%	4%	11%	8.2
Sprint (FON)	C-1-1-1	$64.00	$2.10	$2.20	$2.35	30.9	30.0	21.8	$0.65	$0.35	A	-45.6%	11%	1.5%	40%	80%	6.1
WorldCom (WCOM)/p/q/	D-3-1-9	$38.81	$0.39	$0.87	[illegible]	NM	44.6	19.4	($0.05)	$0.15	A	NM	25%	0.0%	NM	9%	4.3
ACC Corp (ACCC)	6-6	$50.31	$0.98	$1.27	$1.73	51.3	39.6	26.1	$0.18	$0.22	A	21.8%	29%	0.0%	NM	111%	10.1
Frontier (FRO)	C-2-2-7	$27.25	$1.58	$0.97	$1.07	19.2	28.1	15.5	$0.50	$0.34	A	-17.7%	11%	3.3%	90%	54%	7.8
LCI International (LCI)	D-3-2-9	$33.13	$0.97	$1.30	$1.60	33.1	24.3	20.1	$0.20	$0.25	A	24.8%	20%	0.0%	NM	46%	7.0
Qwest Comm. (QWST)/p/q/	D-3-2-9	$36.00	($0.36)	[illegible]	($0.30)	NM	NM	NM	NA	($0.37)	A	NM	NA	0.0%	NM	NM	NM
RSL Comm (RSLCF)/p/q/	**RSTR	$24.75	($3.23)	RSTR	RSTR	NM	NM	NM	($1.46)	($0.77)	A	NM	NA	0.0%	NM	RSTR	RSTR
"Big 3" Long Distance Avg						32.3	31.9	26.3				-40.0%	11%	1.1%	41%	54%	7.3
Long Distance Average						33.2	33.3	24.4				-15.8%	17%	0.8%	53%	37%	8.1
S&P 500		1,044.6	$45.34	$49.00	$56.41	23.2	21.6	20.8					10%	1.8%	32%		

* Recurring EPS
**RESTRICTED. SOLICITATION OF CUSTOMER ORDERS IS PROHIBITED.
[1] % Internally Financed = (Net Income+Depreciation)/(CAPX+Dividends)

Core results started to show some improvement in 4Q...

Long distance company results began to show some improvement in the fourth quarter. Surging demand for data and Internet products, a slight deceleration in the rate of market share losses and cost cutting partially offset long distance share losses and pricing pressures. On average, fourth quarter core EPS growth for the Big 3 was in line with 4Q96's results – versus the declining trend set during the first three quarters of '97 (see Table 2). In addition, WorldCom, LCI, Qwest and RSL continued to post positive results as a result of revenue growth driven by market share expansion in addition to controlling costs.

Table 2: EPS from Core* Long Distance Operations

Company	1Q96	2Q96	3Q96	4Q96	1996	1Q97	2Q97	3Q97	4Q97	1997
AT&T	$1.00	$1.09	$1.02	$0.93	$4.04	$0.92	$0.80	$0.92	$1.05	$3.69
Y/Y Growth						-8.0%	-26.6%	-9.8%	12.9%	-8.7%
Sprint	$0.84	$0.85	$0.85	$0.86	$3.42	$0.83	$0.91	$0.93	$0.98	$3.73
Y/Y Growth						-1.2%	7.1%	9.4%	14.0%	9.1%
MCI	$0.54	$0.53	$0.55	$0.56	$2.18	$0.57	$0.57	$0.48	$0.41	$2.03
Y/Y Growth						5.6%	7.5%	-12.7%	-26.8%	-6.9%
Average Growth						-1.2%	-4.0%	-4.3%	0.0%	-2.2%

Core results exclude impact from new initiatives (i.e. Local, PCS, Global Alliances, Internet, etc.)
Source: Company Reports

...yet new initiatives continue to drag on consolidated EPS.

Despite improvements in the core long distance business, consolidated EPS for AT&T, Sprint and MCI continued to suffer as a result of dilutive, but competitively necessary, new initiatives like local entry, PCS, data and Internet services, and global alliances. It is imperative for the Big 3 to absorb the start-up costs associated with these new initiatives to effectively compete with a full array of products and services in order to protect their imbedded, yet vulnerable, customer base.

On average, the Big 3's consolidated EPS declined 40% in the fourth quarter with AT&T up 2.6%, MCI down 77% and Sprint down almost 46% (see Table 3). New initiatives diluted AT&T's fourth quarter EPS by $0.24, MCI's by $0.31 and Sprint's by $0.63. We forecast that the dilution from new initiatives has not peaked yet and we expect increased dilution through '98 as the companies continue to expand their PCS coverage, data initiatives, local networks, and global alliances.

While 2nd tier companies continue to grow robustly.

Unlike their Big 3 peers, WorldCom, LCI, and ACC showed positive EPS growth in the fourth quarter as a result of solid operations and easier year-over-year comparisons. WorldCom's EPS grew from ($0.05) in 4Q96 to $0.15 as a result of strong revenue growth, impressive cost controls, and synergies from the MFS merger. LCI reported EPS growth of 24%, driven by solid top line growth as result of continued market share gains. Fueled by its expansion into new markets, ACC's bottom line rose 22% in the fourth quarter.

Table 3: Consolidated EPS Growth

Company	1Q97	2Q97	3Q97	4Q97	1997
AT&T	$0.68	$0.59	$0.71	$0.81	$2.78
Y/Y Growth	-25.3%	-37.9%	-15.6%	2.5%	-20.6%
MCI	$0.42	$0.40	$0.19	$0.10	$1.11
Y/Y Growth	0.2%	-7.6%	-56.8%	-77.1%	-36.0%
Sprint	$0.67	$0.60	$0.49	$0.35	$2.10
Y/Y Growth	-14.6%	-20.7%	-33.1%	-45.6%	-27.7%
Average Y/Y Growth	-19.2%	-22.1%	-35.1%	-40.1%	-28.1%

Source: Company Reports

> *Low barriers to entry have led to significant market share losses for the Big 3.*

We have long pointed out that the 1996-1997 phenomenon of unanticipated losses to long distance resellers and thus dramatic EPS declines for existing carriers from '96 to '97 evidenced one single thing: that the long distance industry, especially the mass market residential and single-line business markets, had very low barriers to entry. New entrants have continued to take market share away from AT&T, MCI and Sprint. The most recent FCC long distance market share study (3Q97) shows the Big 3 market share as a percentage of total revenues trending down – totaling only 77.6% in December 1996 versus 81.3% as of December 1995.

> *The Big 3's share continued to trend down in 1996.*

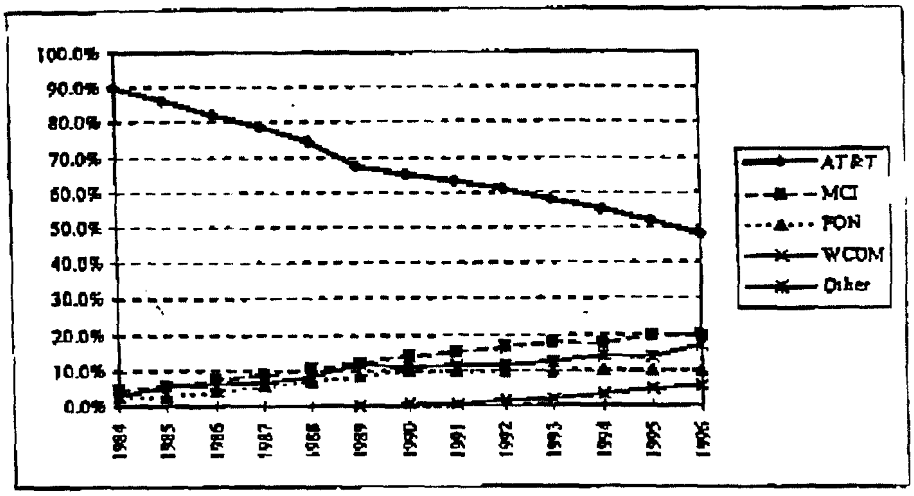
Table 4: Long Distance Market Share
Based on a Percentage of Total Long Distance Revenues

	AT&T	MCI	FON	Total Big 3	WCOM	Other
1984	90.1%	4.5%	2.7%	97.3%	–	2.6%
1985	86.3%	5.5%	2.6%	94.4%	–	5.6%
1986	81.9%	7.6%	4.3%	93.8%	–	6.3%
1987	78.6%	8.8%	5.8%	93.2%	–	6.6%
1988	74.6%	10.3%	7.2%	92.1%	–	8.0%
1989	67.5%	12.1%	8.4%	88.0%	0.2%	11.8%
1990	65.0%	14.2%	8.7%	88.9%	0.3%	10.8%
1991	63.2%	15.2%	9.9%	88.3%	0.5%	11.3%
1992	60.8%	16.7%	9.7%	87.2%	1.4%	11.6%
1993	58.1%	17.8%	10.0%	85.9%	1.9%	12.3%
1994	55.2%	17.4%	10.1%	82.7%	3.3%	14.0%
1995	51.8%	19.7%	9.8%	81.3%	4.9%	13.8%
1996	47.9%	20.0%	9.7%	77.6%	5.5%	17.0%

Source: FCC Long Distance Market Share Report – 3Q97

AT&T's share continues to trend down.

Figure 1: Long Distance Market Share
Based on Revenues of Long Distance Carriers Only



Source: FCC Long Distance Market Share Report - 3Q97

The long distance market share shift continued through 4Q.

We estimate second tier company market share gains decreased slightly in the later half of 1997 . Nevertheless, the long distance market share shift continued through the fourth quarter – as evidenced by the disparity of the revenue growth statistics between the Big 3 and second tier players *(shown in Table 5)*. The average revenue growth rate for the Big 3 dropped from 7.2% in 1996 to 2.6% in 4Q97. These single digit figures for the Big 3 compare with average second tier company composite growth rates of over 20% in 1996 and 31% in 4Q.

Table 5: U. S. Long Distance Revenue Growth Trends (in $000's)

	1996	1997	Y/Y Growth	3Q96	3Q97	Y/Y Growth	4Q96	4Q97	Y/Y Growth
AT&T	46,241	46,174	0.0%	11,739	11,695	-0.4%	11,651	11,739	0.8%
MCI	16,784	17,691	5.4%	4,274	4,410	3.2%	4,302	4,544	5.6%
Sprint	8,302	8,950	7.8%	2,084	2,252	8.1%	2,164	2,312	6.8%
Total "Big 3"	*$71,327*	*$72,815*	*2.7%*	*$18,097*	*$18,357*	*1.4%*	*$18,117*	*$18,595*	*2.6%*
2nd Tier:									
Worldcom	5,213	6,952	33.4%	1,333	1,782	33.6%	1,484	1,928	29.9%
Frontier	1,888	1,645	12.9%	496	424	-14.6%	[illegible]	415	1.0%
LCI	1,216	1,390	14.3%	318	400	25.8%	321	414	29.0%
ACC	99	120	21.0%	21.	31	47.6%	26	38	46.1%
RSL	86	195	127%	23	58	152%	28	67	139%
IXC	204	421	106%	61	112	84.0%	73	136	86%
EXCEL	1,091	1,333	22.2%	300	294	-1.7%	358	467	30.5%
Tel-Save	305	232	31.5%	60	80	33.3%	64	78	21.9%
GTE	44	312	NM	-	80	NM	–	90	NM
SNET	101	142	40.6%	23	37	60.0%	33.5	41	24.1%
Total 2nd Tier	*$10,247*	*$12,742*	*24.4%*	*$2,641*	*$3,298*	*24.9%*	*$2,796*	*$3,672*	*31.3%*
Total LD	$81,547	$85,557	4.9%	$20,082	$21,147	6.3%	$20,913	$22,267	6.5%

Source: Company reports, Merrill Lynch estimates

The two primary drivers of increasing LD competition:

As new, low cost long distance capacity comes on line over the next 6-12 months (e.g., the Qwest, IXC and Williams networks among others) and the RBOCs begin to enter the long distance market as buyers of large quantities of wholesale capacity, the wholesale/retail spread is likely to widen, attracting more competition – unless retail rates drop significantly.

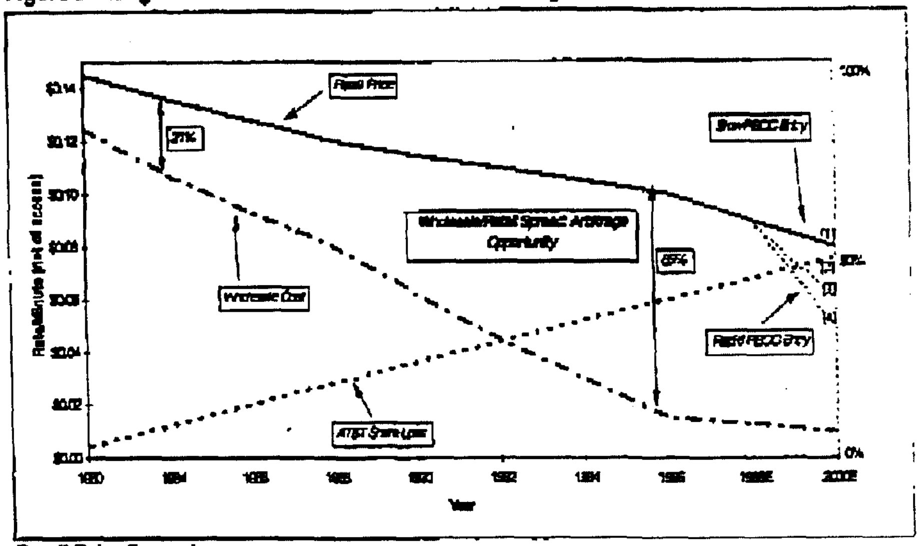
Pace of RBOC entry will dictate retail LD pricing structure.

We believe the pace at which the RBOCs are allowed to enter the long distance market will dictate the retail pricing structure over the next few years. With slower RBOC entry, we should see moderate acceleration in long distance pricing pressure *(see Figure 2, Scenario 1)*. However, with quicker RBOC long distance entry, we forecast retail rates will decline at a more rapid pace, thus causing a dramatic increase in pricing pressure on the LD industry *(see Figure – Scenario 4)*.

AT&T is at most risk from RBOC entry, as a result of high exposure to mass markets.

It is important to note the RBOCs are expected to initially target the mass markets (residences and small businesses) for long distance. As a result, the RBOCs will affect the long distance companies in varying degrees based on their exposure in these markets. For example, we believe AT&T is at most risk due to its relatively high degree of exposure in the small business and residential markets while WorldCom, Qwest, and Frontier hold a relatively strong position due to a less than proportionate share in the residential market.

Figure 2: Long Distance Wholesale/Retail Price Arbitrage



Retail Price Scenarios:

[1] Slowest RBOC long distance entry.
[2] Slow RBOC long distance entry.
[3] Moderate RBOC long distance entry.
[4] Rapid RBOC long distance entry.

New products should put further pressure on long distance rates.

We have seen a number of new, low rate long distance products offered by various providers over the past few months which should put further pressure on pricing. AT&T announced two new products at its analyst meeting in January. One product virtually mirrors Tel-Save's 9¢ per minute offer on AOL wherein the call is a routine long distance call with normal access charges associated with it however, sales, order entry, and billing are all done on-line, thereby lowering SG&A, billing and uncollectable expenses. The second product is Internet voice service, offering phone-to-phone service which is comparable to using a calling card. The Internet voice product is a reaction to recent similar product introductions by Qwest and RSL which offer domestic service at 7.5¢ per minute and international service at 30-40¢ per minute, respectively. AT&T has not yet announced an international product but we believe the roll-out is not far behind.

We do not dispute that these new products offer advantages, yet we believe there is an inherent risk of cannibalization of higher rate Dial-1 LD traffic. Additionally, despite the SG&A cost savings, we believe that long distance profit per minute (not necessarily percentage margin) will be squeezed. As shown in Table 6, even when we assume a 67% reduction in SG&A and network operation expenses per

Table 6: LD Profit Margins (Per Minute)

	Dial-1 LD	On-Line	% Change
Average Rate	$0.14	$0.100	-28.6%
Access	($0.05)	($0.05)	0.0%
SG&A	($0.035)	($0.011)	-68.6%
Network Ops	($0.015)	($0.005)	-66.7%
Depreciation	($0.01)	($0.01)	0.0%
Net Profit	$0.030	$0.024	-20.0%
Profit Margin	21.4%	24.0%	+12.2%

Source: Merrill Lynch estimates

minute and margin expansion of almost 3 percentage points, the new on-line product's net profit per minute declines to 2.4¢ versus 3¢ for traditional Dial-1 long distance services *(See AT&T's 4Q Review, on page 17)*.

The LD Gap remained relatively high in 4Q.

Despite numerous price increases and huge growth in data/Internet transmissions price pressures more than doubled in 1997. As shown below in Table 7 and Figure 3, the average rate per minute declined by 8.0% in 4Q, compared to a 2.8% decline in 4Q96. For 1997, the average rate per minute fell 6.5% versus 2.2% in 1996. Although the declining Gap trend began to flatten out at the end of 1997, it remains relatively high when compared to historical levels – even before RBOC long distance entry. We attribute the current levels of rate per minute declines to two primary factors: (1) Most data traffic is carried on wholesale-priced Internet Protocol (IP) private line networks, thus deeply discounted from typical retail rates; and (2) Retail voice traffic rates continue to be under pricing pressure as a result of increased competition.

Figure 3: Long Distance "Gap" Analysis

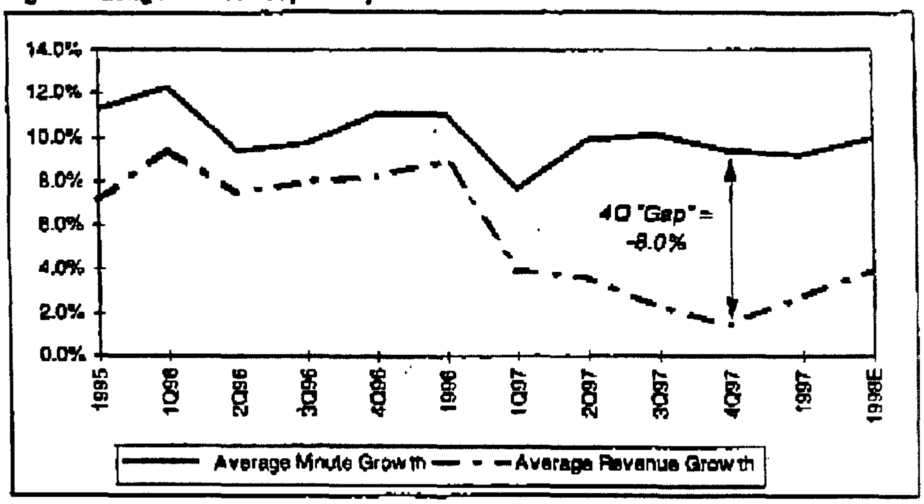


Figure 4: Total RBOC/GTE Minutes of Use Growth

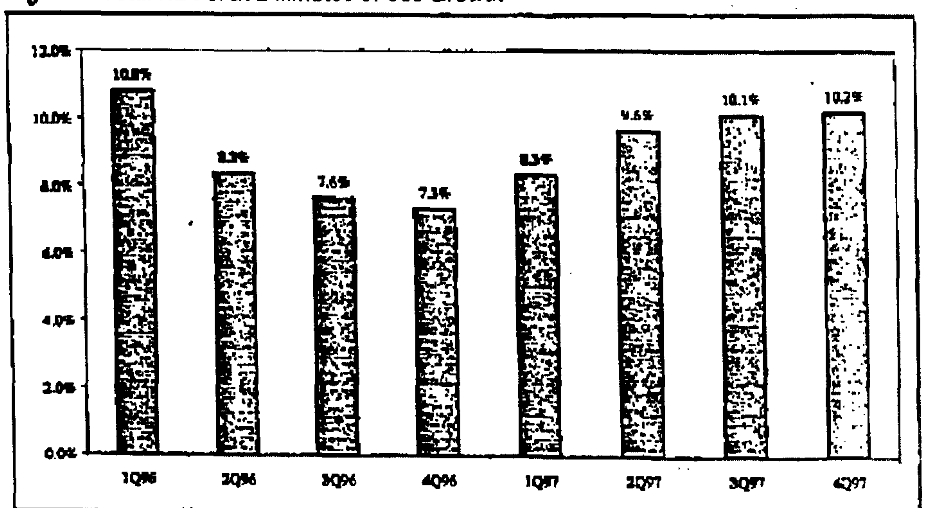


Table 7: Long Distance Revenue/Volume ("Gap") Analysis

	1995	1Q96	2Q96	3Q96	4Q96	1996	1Q97	2Q97	3Q97	4Q97	1997	1998E
LD Minute Growth												
AT&T	8.6%	7.7%	5.1%	5.1%	6.0%	6.0%	6.7%	9.7%	10.1%	7.2%	8.4%	9.0%
MCI	16.2%	21.3%	14.5%	11.0%	8.0%	13.7%	4.0%	5.5%	6.2%	9.7%	6.4%	8.5%
Sprint	7.1%	17.3%	19.0%	21.0%	21.0%	19.6%	14.0%	15.0%	13.5%	12.0%	13.8%	11.3%
Frontier	60.2%	86.6%	64.2%	29.7%	-10.7%	35.7%	-24.7%	-27.0%	-21.8%	1.4%	-19.2%	6.7%
LCI	47.8%	69.6%	75.7%	71.2%	57.5%	67.8%	38.1%	39.0%	33.0%	30.0%	34.7%	35.0%
Worldcom	31.0%	22.5%	20.4%	22.2%	46.8%	28.3%	23.0%	23.0%	23.0%	23.0%	23.0%	20.0%
Weighted Average	11.3%	12.9%	10.2%	10.6%	10.9%	11.0%	7.7%	9.8%	10.1%	9.4%	9.2%	10.0%
Revenue Growth												
AT&T	4.0%	6.6%	3.4%	3.9%	3.9%	4.4%	0.6%	1.5%	-0.4%	-2.3%	-0.1%	1.8%
MCI	12.5%	14.1%	12.7%	11.4%	10.0%	12.0%	8.2%	4.7%	3.2%	5.5%	5.4%	5.2%
Sprint	6.9%	14.2%	15.9%	14.1%	12.3%	14.1%	8.5%	7.8%	8.1%	6.3%	7.8%	9.0%
Frontier	46.5%	63.2%	47.1%	22.6%	-7.1%	27.6%	-17.5%	-18.3%	-14.6%	1.1%	-12.9%	3.5%
LCI	48.9%	80.2%	86.4%	72.6%	47.7%	69.7%	25.8%	25.7%	25.8%	29.7%	25.6%	23.5%
Worldcom	19.3%	16.8%	17.2%	18.2%	30.4%	20.8%	23.0%	21.7%	19.8%	16.6%	20.1%	19.0%
Weighted Average	7.2%	10.3%	8.5%	8.8%	8.2%	8.8%	4.4%	4.0%	2.6%	1.5%	2.8%	4.0%
Gap												
AT&T	-4.7%	-1.1%	-1.7%	-1.2%	-2.1%	-1.6%	-6.1%	-8.2%	-10.5%	-9.5%	-8.6%	-7.2%
MCI	-3.7%	-7.2%	-1.8%	0.4%	2.0%	-1.7%	4.2%	-0.9%	-3.0%	-4.2%	-0.9%	-1.5%
Sprint	-0.2%	-3.1%	-3.1%	-6.9%	-8.6%	-5.5%	-5.5%	-7.2%	-5.4%	-5.7%	-6.0%	-2.2%
Frontier	-13.7%	-23.4%	-17.1%	-7.1%	3.6%	-8.1%	7.2%	8.8%	7.2%	-0.3%	6.3%	-3.2%
LCI	1.0%	10.6%	10.7%	1.4%	-9.7%	1.9%	-12.4%	-13.3%	-7.2%	-0.8%	-9.1%	-11.5%
Worldcom	-19.6%	-3.7%	3.5%	-0.7%	-6.4%	-0.9%	0.0%	-1.3%	-3.2%	-6.4%	-2.9%	-4.0%
Weighted Average	-4.1%	-2.6%	-1.7%	-1.7%	-2.9%	-2.2%	-3.8%	-6.2%	-7.8%	-8.0%	-6.5%	-6.0%

"Gap" represents the difference between annual minute growth and annual revenue growth

A negative Gap implies average rate per minute is declining at the indicated annual rate.

WCOM revenue figures represent estimated switched LD revenues after 1995.

WCOM 1997 MOU growth is Merrill Lynch estimate and normalized for 4Q96 migration of Excel traffic and 1Q95 Wiltel acquisition.

Source: Company reports, Merrill Lynch estimates.

Despite the negative pricing trends mentioned above, we expect "Gap" to marginally improve during the next year as the year-over-year comparisons get easier. We caution that this should not be interpreted to mean price competition is easing in long distance. On the contrary, as highlighted earlier, we expect even more competitive inroads by new entrants offering new products, including the RBOCs eventually, which should continue to drive LD prices downward.

LD companies rode the consolidation wave into 1998.

Consolidation continued to make headlines with the competing Worldcom and GTE bids for MCI, WorldCom's purchase of Brooks Fiber, LCI's acquisition of US Long Distance, Teleport's planned acquisition of ACC and, subsequently, AT&T's bid for Teleport. In addition, Frontier has made a play to offer an array of data products/services through its planned acquisition of GlobalCenter. We expect the consolidation wave will continue in 1998. In addition, once the WorldCom/MCI deal is closed, British Telecom is free and financially capable to establish new partnerships with other companies in the U.S. We believe BT will look to piece together a vertically integrated local, long distance, voice and data company in the U.S. and might look to companies such as the RBOCs, LD companies (i.e., Sprint, LCI, Frontier, and Qwest) and/or the CLECs (i.e., ICG, Intermedia, Teligent, USN).

LD entry into local markets is still at a stand still.

Local entry by the long distance companies continues to take shape at a much slower pace than many had originally expected – as evidenced by MCI's third quarter announcement highlighting the difficulties, delays and costs it is experiencing in its efforts to enter the local market via MCI Metro and AT&T's and MCI's pullout from the total service resale (TSR) market in the fourth quarter. Sprint has yet to roll-out its local offerings on a broad scale, and even smaller long distance companies like LCI and ACC are rolling out much slower than they had originally hoped.

AT&T has finally started to focus on the local market with the acquisition of Teleport.

The acquisition of Teleport finally launched AT&T into the local market, although even with the CLEC's vast local assets AT&T's national local exposure is still limited. AT&T says Teleport's assets will address only 28% (or $21 billion) of the $75 billion local market (excluding approximately $25 billion of access revenues), thus leaving the remaining $54 billion to be addressed by resale and unbundling strategies, which thus far have proved to be uneconomic and/or extremely complex physically and legally. In addition, AT&T's access savings and revenue synergies from the TCG acquisition imply less than 1% per year incremental local share gain than would have occurred without such a merger *(See Appendix 5: Implications of AT&T's Acquisition of Teleport).*

Table 8: IXC Penetration of Local Market

	1997E		1998E		1999E	
Local Telecom Market Revenue	***$102,700***		***$107,065***		***$111,616***	
	Revenue	% of Local Market	Revenue	% of Local Market	Revenue	% of Local Market
AT&T [1]	633	0.62%	1,152	1.08%	1,698	1.52%
MCI [2]	345	0.34%	1,552	1.45%	2,638	2.36%
Sprint	160	0.16%	184	0.17%	212	0.19%
WorldCom [3]	1,006	0.98%	1,558	1.46%	2,179	1.95%
Total	***$2,144***	***2.09%***	***$4,446***	***4.15%***	***$6,725***	***6.02%***

[1] Figures pro forma for Teleport merger
[2] MCI figures are before merger with WCOM and are likely to be scaled back as a result of the merger.
[3] Figures pro forma for MFS and Brooks Fiber mergers.
Source: Company reports, Merrill Lynch estimates.

Fourth Quarter LD Operating Results

SG&A as a percentage of revenues declined for all the companies that we were able to measure.

On an annual comparison, SG&A as a percent of revenues declined for all of the companies we were able to measure – AT&T, MCI, Sprint and LCI. AT&T kept up its improving trend as the company has committed itself to decreasing its SG&A margins to 22% of core long distance revenues by the end of 1999. AT&T's SG&A as a percentage of revenues declined by 110 basis points versus 3Q. As a result of MCI's aggressive marketing campaign to win-back share during the fourth quarter (e.g., its 5¢ Sundays campaign and new airline frequent traveler award partnerships), SG&A as a percentage of revenues rose 120 basis points sequentially. Sprint's SG&A spending as a percentage of revenues fell 70 basis points sequentially in 4Q as the company continues to ride the wave of success surrounding the Sprint Sense and Friday's Free, it has been able to limit its advertising and promotional spending. LCI continued focus on efficiency gains resulted in a annual 40 basis point decrease in its SG&A margins.

Operating margin trends were mixed.

Operating margins fell for some companies while they rose for others in the fourth quarter. AT&T and Sprint showed slight improvements sequentially as result of both SG&A and access spending improvements. AT&T's operating margin rose 230 basis points over 3Q while Sprint's margin rose 90 basis points over 3Q's margin. On the other hand, MCI, Frontier and LCI saw declining operating margins. Sequentially, Frontier's operating margins fell 30 basis points and LCI's margins declined 70 basis points due to increased network costs while awaiting to shift traffic to Qwest and IXC fibers, respectively.

Table 9: Access Expense, SG&A Expense and Operating Income
(as a Percentage of Revenues)

Company	4Q96	1996	3Q97	4Q97	1997	1998E	Improvement Annual	Improvement Seq'l
Access as a % of Revs:								
AT&T	36.3%	35.3%	33.9%	33.8%	35.3%	35.5%	-2.5%	-0.1%
MCI	49.6%	50.1%	53.9%	54.4%	52.6%	52.8%	4.8%	0.5%
Sprint	45.6%	44.8%	42.6%	42.1%	44.0%	43.6%	-3.5%	-0.5%
LCI	63.0%	64.0%	64.0%	65.5%	64.5%	62.7%	2.4%	1.5%
WCOM	57.2%	55.2%	NA	NA	NA	NA	NA	NA
SG&A as a % of Revs:								
AT&T	32.1%	32.0%	33.1%	32.0%	32.5%	28.5%	-0.1%	-1.1%
MCI	26.4%	26.2%	23.2%	24.4%	24.1%	24.6%	-2.0%	1.2%
Sprint	25.3%	23.7%	22.2%	21.6%	21.9%	21.4%	-3.7%	-0.7%
LCI	24.8%	25.1%	24.5%	24.4%	24.4%	24.9%	-0.4%	-0.1%
WCOM	16.3%	17.8%	NA	NA	NA	NA	NA	NA
LD Operating Margin:								
AT&T	14.8%	17.3%	13.7%	15.9%	13.7%	16.9%	1.1%	2.3%
MCI	14.5%	14.6%	12.2%	10.4%	13.1%	11.6%	-4.0%	-1.7%
Sprint	11.9%	11.9%	12.8%	13.7%	12.2%	13.3%	1.8%	0.9%
FRO	8.4%	12.2%	3.3%	3.0%	3.6%	6.6%	-5.4%	-0.3%
LCI	11.9%	11.2%	11.6%	11.2%	11.6%	12.6%	-0.7%	-0.4%
WCOM	20.0%	20.0%	NA	NA	NA	NA	NA	NA

Access is percent of LD revenues. For MCI and Sprint SG&A and operating margins are for long distance unit only. AT&T and Sprint access figures are access only, all others include some network costs.

Fourth Quarter Earnings Were $0.81 Per Share

Full-year 1997 Earnings Were $2.74 Per Share

FOURTH QUARTER AND 1997 SUMMARY

- ***Earnings from continuing operations*** were $0.81 per share, up 5.2% from $0.77 per share in the fourth quarter of 1996. Earnings for the full year were $2.74, down 20.6% from $3.45 in 1996.
- ***Earnings from the core business*** - long distance and cellular services - were about $1.05 per share, an increase of about 13% from $0.93 in the fourth quarter of 1996. The increase reflects AT&T's efforts to achieve a competitive cost structure, including the elimination of over $1 billion from AT&T's annualized fourth quarter cost run rate (excluding certain transitory expenses such as costs for the year 2000 project). For the year, the core business earned $3.69, down 8.7% from $4.04 in 1996.
- ***Investment in initiatives*** - local service, international markets, AT&T WorldNet and other online services, new wireless markets, and AT&T Solutions reduced earnings by $0.24 per share, compared to $0.16 per share a year ago. For the year, initiatives reduced earnings by $0.95, compared to $0.59 in 1996.
- ***Revenue*** decreased 0.3% in the quarter as a result of a 2.3% decrease in long-distance revenue. Lower revenue from consumer long-distance markets, related largely to the flow-through of access reductions to customers, resulted in the decline. Total revenue increased 1.5% for the full year, while long-distance revenue was essentially flat compared to 1996.
- ***Long-distance calling volume*** increased 7.2% in the fourth quarter and 8.7% for the year led by strong demand for toll-free and outbound service for business customers.

4TH QUARTER & 1997 AT A GLANCE

	Growth Compared To:		
Revenue	**4Q96**	**3Q97**	**1996**
Total	(0.3)%	(1.4)%	1.5%
Long-distance Services	(2.3)%	(2.6)%	(0.1)%
Business LD Services	3.0%	(1.4)%	2.9%
Consumer LD Services	(6.8)%	(3.8)%	(2.8)%
Wireless Services	4.2%	2.9%	10.3%
Other Key Data			
Long-distance Volume	7.2%	(0.5)%	8.7%
SG&A Expense	(2.5)%	(6.0)%	0.7%

AT&T 1997 CONTINUING OPERATIONS HIGHLIGHTS

Total Revenue:	**$51.3 Billion**
Total Net Income:	**$4.6 Billion**
EBITDA:	**$11.3 Billion**
Total Capital Expenditures:	**$7.2 Billion**
Cash Generated or Expected from Divestiture Program:	**$6.7 Billion**
At December 31, 1997, Value of $1,000 Invested in AT&T Stock on December 31, 1996:	**$1,537**

EARNINGS RECAP

EPS from:	**1997**	**4Q97**	**3Q97**	**2Q97**	**1Q97**	**1996**	**4Q96**	**3Q96**	**2Q96**	**1Q96**
Core Business	**$3.69**	$1.05	$0.92	$0.80	$0.92	**$4.04**	$0.93	$1.02	$1.09	$1.00
Initiatives	**(0.95)**	(0.24)	(0.23)	(0.23)	(0.25)	**(0.59)**	(0.16)	(0.17)	(0.16)	(0.10)
Continuing Operations	**2.74**	0.81	0.69	0.57	0.67	**3.45**	0.77	0.85	0.93	0.90
Discontinued Operations	**0.06**	--	0.02	0.02	0.02	**0.11**	0.13	0.04	(0.01)	(0.05)
Gain on Sale of Discontinued Operations	**0.04**	--	0.04	--	--	**0.10**	0.10	--	--	--
Consolidated AT&T	**$2.84**	$0.81	$0.75	$0.59	$0.69	**$3.66**	$1.00	$0.89	$0.92	$0.85

In December, AT&T reached an agreement to sell AT&T Universal Card Services (UCS). Accordingly, the results of UCS have been removed from AT&T's consolidated financial statements and are accounted for as discontinued operations. Financial results for 1997 and 1996 have been restated to reflect this change. Appendix C shows restated 1997 quarterly data and 1996 fourth quarter and annual data.

Note: All earnings-per-share figures in this document are presented on a diluted basis.

Income Statement Discussion

REVENUE

Business long-distance services revenue was $5.543 billion in the fourth quarter, up 3.0% from 4Q96 driven primarily by data services revenue growth in the mid-teens. For the full year, total business long-distance revenue grew 2.9%, with double-digit growth in data revenue. Throughout the year, demand for emerging data services such as frame relay led the growth in data services revenue, while growth in private line data services also contributed significantly. Revenue from frame relay services grew well in excess of 100% in 1997. Excluding the impacts of businesses that AT&T sold in 1997, namely AT&T Skynet and AT&T Tridom, total business long-distance revenue grew 4.0% in 4Q97 and 3.5% for the year.

As expected, the rate of growth in business calling volume declined slightly from previous quarters, though continuing to grow at a double-digit rate with gains in both inbound and outbound calling. For the year, business volume increased at a rate in the mid-teens. The lower rate of growth in the quarter was related primarily to strong volume in the fourth quarter of 1996, when a spurt of contract renegotiations began due in part to uncertainty surrounding detariffing. Contract activity and the corresponding pressure on prices continued throughout 1997, leading to strong volume growth and a substantial gap between volume and revenue growth. Reductions in access charges led to further price decreases-and a wider gap-as savings were passed to customers, often in advance of AT&T's realization of lower rates. The gap, which has also been caused by growth in lower-priced intra-LATA services and migration of customers from switched to nodal services, narrowed in the fourth quarter. The anniversary of the increase in contract activity, the impact of certain price increases implemented in the fourth quarter, and increases in data revenue growth caused the gap to shrink.

International business calling volume grew at a double-digit rate for the quarter as well as for the entire year, driven by strong demand for both outbound and inbound international calling.

Compared to the third quarter, business services revenue declined 1.4%, on a low-single-digit decrease in volume. This performance is consistent with seasonal patterns related to the occurrence of fewer business days in the fourth quarter.

Consumer long-distance services revenue was $5.845 billion in the fourth quarter, down 6.8% compared to 4Q96. Revenue was impacted by a number of factors in the fourth quarter. In the second half of the year, AT&T stopped targeting unprofitable customers, and in the fourth quarter accelerated the migration of high-usage customers to more favorable optional calling plans. These efforts are part of AT&T's plan to target and retain the most profitable residential customers. AT&T was able to put customers on more favorable rate plans, as well as lower basic rates, as a result of lower access costs. Other factors affecting revenue in the fourth quarter and throughout 1997 included the continued competition in residential long-distance markets, as well as the use of free minutes (which have a contra-revenue effect) as a customer incentive. For the full year, consumer long-distance revenue declined 2.8%, or about 0.8% adjusted for the impacts of free minutes and access reform.

Note To Readers
To assist investors in understanding the performance of AT&T's established businesses, as distinct from the dilutive impacts of investments in new business areas, this document presents certain information in terms of "core" businesses and "initiatives". *Earnings per share, EBIT, EBITDA, capital expenditures,* and *assets* related to initiatives are provided separately. *Revenue* for initiatives is included in the "Local and Other Initiatives" and "Wireless Services" revenue lines, as appropriate. Core businesses include: business and consumer long distance services (inter- and intra-LATA toll, network management, data services, messaging, and other network-enabled services and related product sales); wireless voice services in existing 850 MHz markets; air-to-ground services; and wireless product sales. Initiatives include: local service; wireless service in new 1.9 GHz markets; wireless data

service; online services such as AT&T WorldNet and Website Services; the AT&T Solutions outsourcing, consulting, and systems integration business; and international expansion.

All financial data presented on a "core" and "initiatives" basis should be considered approximate. Data on initiatives include costs and expenses on an incremental basis, and require certain estimates and allocations that management believes provide a reasonable basis on which to present such information. Also, the revenue, EBIT, and EBITDA amounts include the impact of sales between revenue categories; such revenues are eliminated in the "Other and Eliminations" line.

Also, note that this document contains certain forward-looking statements which rely on a number of assumptions concerning future events, and are subject to a number of uncertainties and other factors that could cause actual results to differ materially from such statements. Readers are directed to AT&T's filings with the SEC for more information related thereto. AT&T disclaims any intention or obligation to update or revise any forward-looking statements.

LONG-DISTANCE SERVICES - 1997 RECAP

Year-over-year Growth in:	**FY 1997**	**4Q 1997**	**3Q 1997**	**2Q 1997**	**1Q 1997**
Calling Volume	8.7%	7.2%	10.1%	9.7%	6.7%
Total Long-distance Revenue	(0.1)%	(2.3)%	(0.4)%	1.5%	0.6%
Business Long-distance Revenue	2.9%	3.0%	1.9%	4.1%	2.4%
Consumer Long-distance Revenue	(2.8)%	(6.8)%	(2.4)%	(0.8)%	(1.0)%

Consumer long-distance calling volume increased at a low-single-digit rate in the fourth quarter. AT&T's efforts to target high-value customers, along with the effects of competition, caused volume growth to slow relative to the previous quarter.

International calling volume in consumer markets declined slightly compared to the fourth quarter of 1996. The decrease was driven by the expiration of certain international promotions, which had helped produce double-digit volume growth rates in late 1996 and the first half of 1997.

Compared to the third quarter, consumer long distance revenue decreased 3.8% on a slight increase in calling volume, primarily due to the slowdown in international growth as well as changes related to the targeting of high-value customers.

Wireless services revenue, which includes wireless product sales, increased 4.2% from 4Q96 to $1.129 billion. For the full year, wireless revenue grew 10.3%. The wireless subscriber base in consolidated markets was 6.019 million at December 31, 1997, an increase of 15.7% over the prior year. These numbers include revenue and subscribers from AT&T's 1.9 GHz markets, nine of which were activated in 1997, including six in the fourth quarter. As of December 31, AT&T had fewer than 100,000 subscribers in these new markets. Throughout 1997, wireless revenue and subscriber growth rates were reduced by 2-3% due to the impact of the disposal of several wireless properties in December 1996.

During the quarter, about 234,000 net wireless subscribers were added to AT&T's consolidated base. This figure represents a decline of 44% compared to the fourth quarter of 1996. The reduction in net subscriber additions, as well as the downward trend in revenue growth evident in the table below, primarily reflects the intense competition in the wireless industry. Competition has been particularly intense in the southwestern and western areas of the United States, where the introductory offers of new market entrants have been met with equally competitive offers from incumbent cellular competitors. The decline also reflects the fact that while new PCS systems have been activated in many of AT&T's cellular markets, AT&T is just beginning to enter new markets using its own 1.9 GHz licenses. Also, AT&T has now focused its efforts on targeting high-value wireless customers and reducing sales of low-end offers in order to improve profitability. Nevertheless, despite the cumulative negative effects of these factors on revenue growth, wireless services revenue in core cellular markets grew 12.1% for the year on an adjusted basis-in line with the industry rate for traditional cellular markets.

AT&T Wireless Services - 1997 Recap *

	4Q97	3Q97	2Q97	1Q97	FY 97
Total Revenue Growth	4.2%	10.4%	13.9%	13.9%	10.3%
Approx. Net Customer Adds (000)	234	188	273	251	946
End-of-period Data	**Dec. 31, '97**	**Sept. 30, '97**	**June 30, '97**	**March 31, '97**	**Dec. 31, '96**
Consolidated Subscribers (000)	6,019	5,769	5,596	5,325	5,204
Total Subscribers (000) **	8,188	7,828	7,638	7,316	7,138
Digital Subscribers - % of					

Digital Subscribers - % of Consolidated	28%	24%	21.0%	19.4%	17.4%
Messaging Subscribers (000)	1,300	1,268	1,231	1,185	1,150

** Data includes 1.9 GHz markets; growth rates not adjusted for impact of disposal of several wireless properties in 1996.*
*** Equals consolidated subscribers plus subscribers in markets where AT&T shares a controlling interest, such as Los Angeles, San Francisco, and Houston.*

Local and other initiatives revenue increased 42.6% to $683 million in the fourth quarter, led by growth in revenue from international markets, outsourcing revenue from AT&T Solutions, and revenue from AT&T WorldNet and local services.

Other and eliminations decreased revenue by $372 million in the fourth quarter. This category reflects the elimination of revenues for services sold between revenue categories (e.g., sales of business long distance services to other AT&T units).

EXPENSES

Access and other interconnection expenses declined 8.9% compared to 4Q96 in spite of growth in calling volume. The decline is primarily attributable to the FCC-mandated reduction in access rates, which took effect July 1, 1997. These savings to AT&T have been passed to customers through reduced price levels in both business and consumer markets. The decrease was also driven by other declines in interstate and intrastate tariffs and in international settlement rates. Access and other interconnection expenses were 33.8% of long-distance services revenue this quarter, compared to 36.3% in 4Q96 and 33.9% in the third quarter. For the year, access expense was down 0.2%, and amounted to 35.3% of long-distance revenue for the full years 1997 and 1996.

Network and other communications services expenses decreased 1.1% compared to 4Q96. A lower provision for uncollectibles accounted for the decline. Partially offsetting this reduction were expenses related to new initiatives, especially local service and AT&T Solutions, as well as expenses for compensation of payphone operators. Payphone compensation expenses were lower in the fourth quarter than in previous quarters due to the reduction of the compensation rate to $0.284 per call from $0.35. This reduction resulted in the reversal of expenses accrued in the first three quarters of 1997. For the year, network and other communications services expenses were up 17.6% due primarily to spending on initiatives and payphone compensation expenses, as well as the purchase of equipment at retail prices from Lucent Technologies.

Depreciation and amortization expenses increased 46.7% from 4Q96, driven by increased capital investments, which includes the impact of purchasing equipment at retail from Lucent. Capital investments in 1997 were directed largely at the deployment of ATM and SONET technology in AT&T's long-distance network, and at AT&T's wireless network and local services initiative.

Selling, general and administrative expenses decreased 2.5% from 4Q96, and 6.0% from the third quarter. For the year, SG&A was up 0.7%. The decline in the fourth quarter is reflective of the AT&T management team's focus on ensuring that AT&T attains a competitive cost structure. While investment in initiatives and transitory spending such as the year-2000 project put upward pressure on spending, AT&T achieved significant reductions in core spending levels. Lower advertising expense across the company, as well as lower customer acquisition costs in consumer markets, driven largely by a reduction in the use of checks to acquire customers, are key examples. Lower marketing and sales expenses in business markets also contributed to the decrease. Retention and acquisition costs in wireless markets were essentially flat in spite of the investment in the migration of customers to digital service; these costs were offset by lower customer adds and reduced average acquisition costs. Cost per gross add in core (850 MHz) wireless markets was down 5.4% in the fourth quarter.

SG&A EXPENSE AS A PERCENTAGE OF TOTAL REVENUE

FY 1997	4Q 1997	3Q 1997	2Q 1997	1Q 1997	1996	4Q96	3Q96	2Q96	1Q96
29.0%	28.4%	29.8%	29.6%	28.3%	29.3%	29.0%	30.5%	30.4%	27.1%

Other Income Statement Items

Other income - net decreased $35 million from the fourth quarter of 1996, primarily due to non-recurring 1996 events such as a gain on the exchange of wireless properties. For the year, other income increased $26 million due primarily to a gain of approximately $100 million on the sale of AT&T Skynet as well as various other insignificant items. While announced in 1997, the sales of AT&T Solutions Customer Care, LIN Television Corporation, and WOOD-TV are expected to close in 1998.

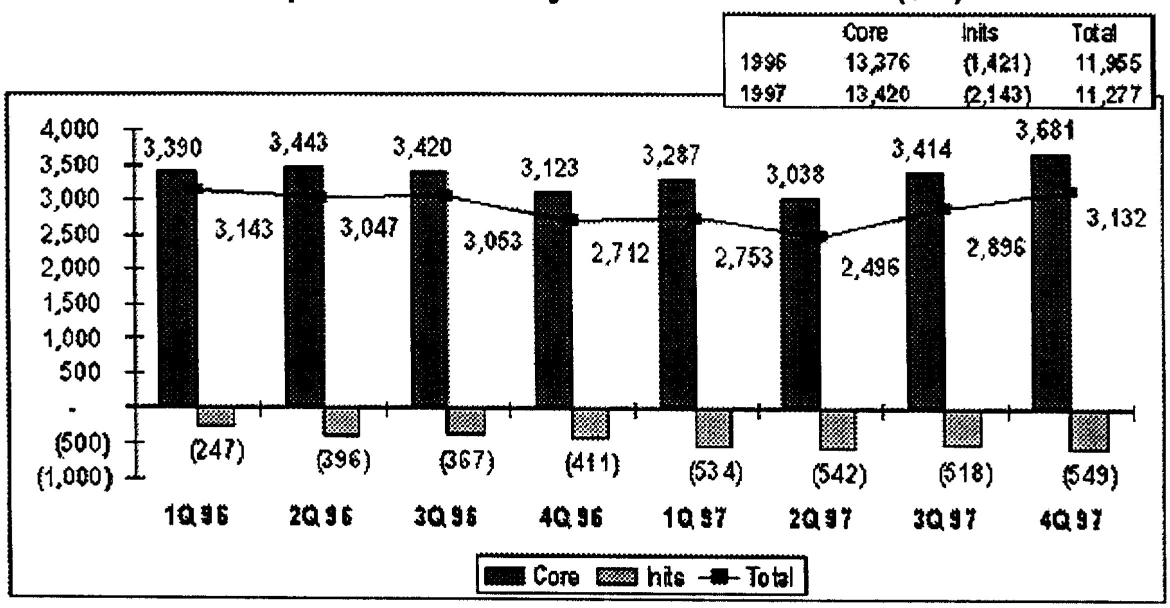
Interest expense decreased $4 million from the year-ago quarter due to a lower average interest rate partially offset by a higher level of average debt. For the year, interest expense decreased $152 million due primarily to a lower level of average debt and a higher percentage of capitalized interest.

Provision for income taxes increased $24 million, or 3.3%, compared to 4Q96 due to higher income. The effective tax rate of 36.0% was down from 36.7% in the year-ago quarter. For the year, provision for income taxes was down $516 million, or 15.9%, due to lower income. The effective tax rate for the full year was 37.8%, compared to 36.7% in 1996.

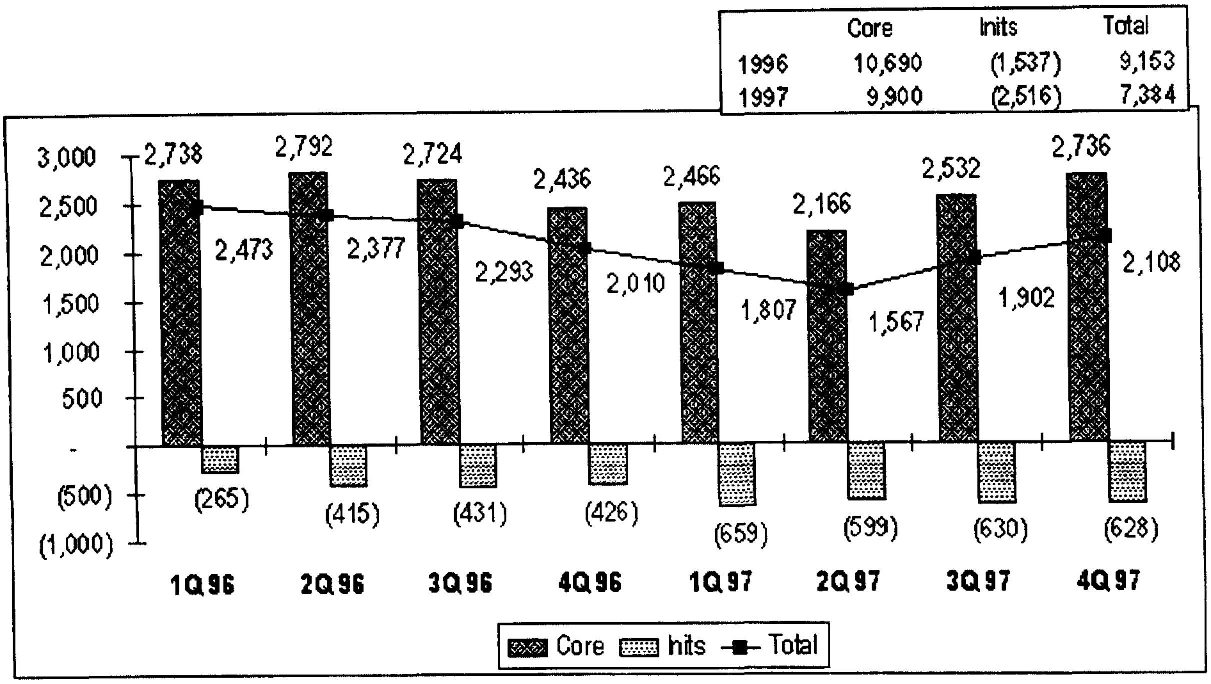
Income from discontinued operations net of taxes was $11 million in 4Q97 and $100 million in 1997. The fourth quarter income relates to AT&T Universal Card Services, while the full year also includes income from AT&T's submarine systems business, which was sold in July.

See Appendix A for complete fourth quarter and full-year income statements.

Graph: AT&T Two-year EBITDA Trend ($B)



Graph: AT&T Two-year EBIT Trend ($B)



AT&T Operating Units - 1997 in Review

Business Markets Division

AT&T's Business Markets Division (BMD) turned in strong 1997 results, in spite of competitive conditions and other factors that put constant pressure on prices for voice services. BMD generated $22.2 billion in core long-distance revenue in 1997, an increase of 3.5% over 1996 adjusting for the impacts of businesses that AT&T sold in 1997 (AT&T Tridom and AT&T Skynet). Calling volume grew at a double-digit rate each quarter in 1997 led by strong demand for both inbound and outbound calling. The booming data business, led by growth in frame relay service, showed double-digit revenue growth each quarter including adjusted growth of over 20% in the fourth quarter. BMD took actions in 1997 to bring its cost structure in line with competitive benchmarks, and also made important moves to strengthen its position in Internet-related services and local service for businesses.

BMD's adjusted annual long-distance revenue growth of 3.5% fell just short of the 4-6% range that management targeted for the year. The substantial gap between volume and revenue growth in voice services was the primary reason for the shortfall. Pricing on voice contracts was under pressure throughout the year, particularly in the first half. This trend had begun in the fourth quarter of 1996, when uncertainty surrounding the possibility of detariffing encouraged many customers to reopen their contracts. As contracts were renegotiated, prices were forced down by competition and by the flow-through of savings to AT&T from access reform. In many cases, access savings were passed along to customers in advance of AT&T's realization of any savings. Competition notwithstanding, BMD held its market position with major contract wins. American Express, Prudential, the State of Florida, American Home Products, CVS, and others signed on with AT&T in 1997.

By the fourth quarter the pricing environment showed signs of stabilizing. BMD increased prices on certain voice and data services, and the gap narrowed as BMD's revenue growth rate increased over the previous quarter. Data services revenue leaped to a 20%+ adjusted growth rate in the fourth quarter. The key driver of that growth was frame relay service, which grew at a triple-digit rate for the year.

In addition to a strong volume and data revenue growth, BMD made progress in 1997 toward a best-in-class cost structure. The streamlining of marketing and customer care organizations, as well as reductions in advertising and promotions, contributed to an improvement in BMD's SG&A levels. Not only did SG&A as a percent of revenue decrease year-over-year, but so did the actual level of SG&A expenditure. Improvement of the cost structure remains as a key issue in 1998.

Also an area of focus in 1998 will be the continuing development of AT&T's position in Internet-related services for businesses. AT&T made important progress in this area in 1997, activating its own carrier-grade Internet Protocol network facilities. This high-quality network is the foundation for business services like AT&T WorldNet MIS and BMD's hosting business for high-volume business web sites.

Local service is a key part of AT&T's plan to be the end-to-end telecommunications services provider for businesses. In 1997, BMD introduced AT&T Digital Link (ADL) local service for medium- to large-sized businesses. At the end of the year, ADL was available in 49 states for outbound local calling. Inbound capability, however, was and remains delayed by the lack of local number portability. In January, AT&T made an aggressive move to expand its reach into the market for business local service and dedicated access by reaching an agreement to merge with TCG. TCG brings to AT&T a valuable collection of local exchange assets in 66 markets, with over 5,000 buildings on its network and a total of 13,500 buildings passed. The merger is expected to close in the second half of 1998.

Consumer Markets Division

1997 was a solid year for the Consumer Market Division (CMD) despite intense competition in the industry. CMD changed its approach to the market, becoming a market-facing organization focused on value and simplicity for customers. For the year, CMD grew long distance volume and increased profit from its core business, and second-half core profit increased more than 20% compared to the first half.

Stabilizing market conditions-reducing churn and using marketing techniques to encourage customer loyalty-was CMD's top priority for the first half of 1997. CMD removed 1.8 million spinners from its acquisition targeting programs, and reduced its reliance on checks to win customers. More than 60% of CMD's customer acquisitions came from checks in 1996. This level came down throughout 1997, falling below 20% in the fourth quarter and getting CMD to one of its key goals for the year. Free minutes began to replace checks as a customer incentive. As spinners and checks declined, CMD moved its focus to customer retention. Over 35 million CMD customers received offers designed to increase their loyalty to AT&T. These offers included the One Rate Plus calling plan for high-value customers, Basic Telephony bundles, and Value Bundles such as the Family Communications bundle.

To improve its offers, CMD rolled out additional flat-rate plans and simplified its variable-rate plans to reduce customer confusion over price and value. Mileage bands were eliminated, and time-of-day rate elements were reduced from eleven to three. AT&T rolled out five new, innovative services in 1997: nationwide directory assistance ("00" information), local messaging in Texas, Call Organizer, Sound Scan, and True Voice Plus.

As CMD changed the focus of its marketing efforts, it also worked to increase the effectiveness of its customer touches. CMD consolidated its direct mail and telemarketing, and realigned itself from an organization managed on a product-line basis to one managed by customer segments. Looking at usage levels and communications habits, CMD divided its customer base into the following segments:

- Growth (High Communicators)
- Developing (Low Communicators)
- Global (Contacts around the World)

- Military (Need to Contact Home and Friends)
- College (Connect with Home, Friends, Information)

Segment managers became responsible for customer relationships, not products, and messages could be consolidated into fewer touches. A single telemarketing call could be used to sell multiple services. The myriad of 800 numbers customers could call to order different services from CMD decreased by more than 60%. And most importantly, offers could be targeted at customers based on their specific needs and spending habits. In 1997 CMD introduced eleven different "value bundles," or multiple-service, single-bill offers designed and targeted for specific customer segments. AT&T sold 188,000 of these value bundles in 1997, plus 3.5 million "basic" bundles such as combinations of long-distance and wireless on a single bill.

The database mining efforts used in the segmentation process during the first half of the year had revealed that CMD's customer base included millions of unprofitable customers. Beginning in the second half of the year, AT&T began to remove unprofitable customers from its targeted acquisition programs. Minute count replaced customer head count as a key measure in CMD's business.

The elimination of unprofitable customers from targeting programs saved over $100 million in marketing and advertising costs in the second half of the year. At the same time, marketing to the high-value segments intensified. Customers with high usage were proactively moved to the most favorable rate plan, and selling of bundled offers accelerated. The plan was to support highly profitable customers with good rates-which further stimulate usage-and packages of services that change the way they communicate. Those two factors have significant impacts on customer loyalty.

The decision to pursue a high-value strategy had certain planned negative short-term effects on CMD's customer base and revenue. Customer headcount acquisition decreased, and volume growth slowed. At the same time, access reductions were passed to customers. These changes had the cumulative effect of actually causing negative revenue growth. However, CMD made the pivot to a high-value strategy in order to improve profitability, and early trends indicate that the move is having the desired effect. The average bill size in minutes of customers joining AT&T increased by about 25% in 1997 compared to 1996, while the customers leaving tended to be of lower value. And as mentioned above, second-half core profits increased significantly.

While CMD made a lot of progress in 1997, much remains to be done in dealing with unprofitable customers, refining the segmentation of the base, and developing the right offers for each segment. Local service, a key element of any bundled offer, remains a question mark. The regulatory environment continues to prohibit CMD from offering local service broadly in an economically advantageous way. However, AT&T is exploring alternative methods of local entry, and is ready with the billing, customer care, and marketing capabilities needed to deliver service to customers.

AT&T WIRELESS SERVICES

Despite very competitive market conditions, AT&T Wireless Services (AWS) turned in strong results in 1997 and is well positioned to continue to lead the industry and help AT&T achieve its goal of enabling communications over any distance, in all forms, to any place. AT&T Wireless focused its efforts in 1997 in three strategic areas: profitability, growth, and integration with AT&T. Adjusting for a gain on the sale of certain properties in 1996, profits (EBIT) from AWS's core business increased approximately 24% in 1997. AWS earned about $700 million in EBIT from its core business in 1997, and over $1.5 billion in EBITDA. Adjusted revenue from cellular services grew 12.1%--in line with the industry rate for traditional cellular markets. Wireless achieved these results in spite of the entry of multiple new competitors in many of its key markets, who pressured revenue and subscriber growth across the industry. AWS also improved its profitability while aggressively migrating analog customers to digital service. Over time, the economic advantages of digital technology, and in particular AT&T's TDMA technology, will add to AWS's profitability. (However, investment is required today in order to realize this benefit in the future.) At the end of 1997, AWS had 2.1 million digital subscribers (including partnership markets), many more than any other cellular or PCS carrier. In fact, Yankee Group recognized AWS for this effort in the fourth quarter by naming it the carrier with the best executed digital strategy.

AWS's enhanced core profitability in 1997 came primarily from efforts to reduce costs. For example, AWS focused on increasing its use of less expensive distribution channels. As a result, cost per gross add (CPGA) fell by 6.1% in 1997. In addition to these short-term profitability initiatives, AWS adopted a strategy designed to boost profitability in the long term. AWS phased out many of its low-usage analog rate plans, eliminated free phones from direct distribution channels, and focused its targeting efforts on high-value customers. Of course, an increased level of customer churn and a slowdown in customer additions was inevitable given the adoption of this strategy and the abundance of low-priced rate plans available from competitors. While competition was the largest factor in AWS's reduced revenue and subscriber growth rates, the quality-over-quantity approach also partly accounts for the slowdown, particularly in the second half of the year.

Growth was another key area of emphasis for AT&T Wireless in 1997. Not growth in the sense of pure subscriber and revenue accumulation at any cost, but rather expansion of AT&T's ability to provide innovative digital communications services across North America, seamlessly to customers and profitably for AT&T. The most significant growth opportunity for AWS is the expansion of its digital footprint in markets where it has acquired 1.9 GHz spectrum licenses. AWS built out ten of these markets in 1997, launching nine of them, with the tenth pending an announcement of a partnership agreement. With the activation of these markets (Phoenix/Tucson, Atlanta, Chicago, Philadelphia, Charlotte, Detroit, Baltimore/ Washington, St. Louis, and Cleveland), plus Boston in January 1998, AT&T Wireless is the only carrier to operate in 24 of the top 25 markets in the U.S. AWS has 130 million digital POPs across the country, a footprint 60% larger than any other carrier. And the tri-modal phones introduced in June offer AWS customers the ability to roam seamlessly across the country on analog systems and digital systems in the 850 MHz and 1.9 GHz spectrum-a capability currently only available with IS-136 TDMA technology. The investment required for this expansion is substantial. AT&T invested nearly $1 billion in capital in 1997 for its 1900 MHz build-out, and the start-up costs, depreciation, and amortization of licenses for these markets cost AT&T over $200 million in EBIT for the year. However, AT&T plans to work with partners in order to both minimize its own investment and accelerate the build-out of TDMA systems. A joint venture with Triton PCS was announced in October, and other deals are planned in 1998.

Maximizing the synergies between AWS and AT&T remains a key priority for the AT&T management team. Bundling of services is a major example of such an opportunity. In 1997 AT&T sold 1.6 million long-distance/wireless bundles, many with integrated customer care. Many of these bundles were sold through AT&T's own retail stores, which have been converted from AWS outlets to stores offering a complete line of AT&T services-long-distance, wireless, pre-paid cards, AT&T WorldNet, personal 800 numbers, and more. Also, AWS's